

Message Text

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INFO OCT-01 ISO-00 SPC-03 AID-20 EB-11 NSC-10 RSC-01

CIEP-02 TRSE-00 SS-20 STR-08 OMB-01 CEA-02 SCEM-02

SCI-06 INT-08 CIAE-00 COME-00 FRB-02 INR-10 NSAE-00

XMB-07 OPIC-12 LAB-06 SIL-01 DRC-01 DODE-00 PM-07

H-03 L-03 PA-04 PRS-01 USIA-15 IO-14 NEA-10 /216 W

----- 080359

R 221714Z DEC 73

FM AMEMBASSY OTTAWA

TO SECSTATE WASHDC 2379

C O N F I D E N T I A L SECTION 1 OF 2 OTTAWA 3097

E.O. 11652: GDS

TAGS: PFOR, CA

SUBJECT: FOURTH QUARTER REPORT: CANADA

1. SUMMARY: AT THE CLOSE OF 1973, A MOOD OF UNCERTAINTY PERMEATES CANADIAN POLITICAL AND ECONOMIC LIFE AS THE COUNTRY-- WITH A MINORITY GOVERNMENT IN POWER AND AN EXPORT-ORIENTED ECONOMY, CLOSELY LINKED TO THAT OF THE US--TRIES TO ASSESS THE IMPACT OF THE WORLD ENERGY SHORTAGE. DESPITE THIS APPREHENSION, THE CANADIAN ECONOMY CONTINUES BASICALLY STRONG AND IS PERHAPS BEST EQUIPPED OF ALL THE INDUSTRIAL DEMOCRACIES TO FACE THE "ENERGY CRISIS" AND ATTENDANT ECONOMIC HARDSHIPS. MOREOVER, THE TRUDEAU GOVERNMENT, WITH THE CONTINUED SUPPORT OF THE SOCIALIST NEW DEMOCRATIC PARTY (NDP), DEFEATED A RECENT TORY NON-CONFIDENCE MOTION 135-117 AND ENJOYS, ACCORDING TO THE LAST GALLUP POLL, A 34-MONTH HIGH IN PUBLIC SUPPORT WITH 43 PERCENT IN ITS FAVOR TO 33 PERCENT FOR THE OFFICIAL OPPOSITION PROGRESSIVE-CONSERVATIVE PARTY (PC) AND 18 PERCENT FOR THE NDP. IT IS EVEN BEGINNING TO APPEAR THAT THE LIBERAL PARTY IS MORE UNCOMFORTABLE IN HARNESS WITH THE NDP THAN VICE VERSA AND THAT IT MAY BE READY IN 1974 TO BITE THE BULLET AND DISSOLVE PARLIAMENT ON ITS OWN RATHER THAN WAIT FOR THE NDP TO JOIN THE OTHER

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OPPOSITION PARTIES AND BRING IT DOWN.

2. CONTRIBUTING FACTORS. THE FOLLOWING FACTORS ARE THE MAIN ONES IN CREATING A MOOD OF UNCERTAINTY IN CANADA AS THE FOURTH QUARTER OF 1973 ENDS: A) PRIMIN TRUDEAU'S LIBERAL GOVERNMENT, WHICH WON ONLY 109 OF 264 SEATS IN COMMONS IN OCTOBER 1972, IS LIKELY TO DECIDE TO GO TO OR BE PUSHED TO THE POLLS IN 1974 WITH THE OUTCOME OF AN ELECTION UNCERTAIN--NOTWITHSTANDING THE LATEST GALLUP POLL'S ASSESSMENT. B) ENERGY PROBLEMS DOMINATE THE ECONOMIC AND POLITICAL SCENE, PROVOKING CONCERN ABOUT AN ECONOMIC DOWN-TURN AND MORE UNEMPLOYMENT, POLARIZING POLITICAL PARTIES, EXACERBATING REGIONAL TENSIONS, AND REQUIRING A CAREFUL EVALUATION OF RELATIONS WITH THE US AND THE REST OF THE WORLD. C) THE GOVERNMENT'S INDUSTRIAL STRATEGY IS TAKING NEW SHAPE WITH BROAD RAMIFICATIONS. D) IN THE LONGER RUN, THERE IS LITTLE CONSENSUS ON HOW PRECISELY TO MANAGE THE FACT OF FOREIGN OWNERSHIP OF MUCH OF CANADA'S RESOURCE AND INDUSTRIAL CAPACITY. E) FINALLY, DESPITE MANY INTENTIONS TO THE CONTRARY, CANADA'S ECONOMY IS INCREASINGLY INTERDEPENDENT WITH THAT OF THE US, WITH THE INTROVERSION OF THE EC THREATENING CANADIAN EFFORTS TO INCREASE ITS TIES AND TRADE WITH WESTERN EUROPE. END SUMMARY.

3. DOMESTIC POLITICS. TRUDEAU'S LIBERALS HOLD ONLY 109 OF THE 264 SEATS IN COMMONS AND SINCE OCTOBER 1972 HAVE HAD TO RELY ON THE 31 MEMBERS OF THE LEFT-WING NDP TO PASS MOST LEGISLATION. THE ALLIANCE IS INCREASINGLY UNCOMFORTABLE FOR BOTH. FURTHER, MORE THAN HALF THE LIBERAL STRENGTH COMES FROM QUEBEC AND ALMOST 85 PERCENT FROM ONTARIO AND QUEBEC COMBINED. DESPITE OVERTURES TO THE WESTERN PROVINCES, TRUDEAU HAS NOT DEVELOPED SUPPORT THERE, AND PUBLIC SQUABBLES WITH ALBERTA AND SASKATCHEWAN OVER OIL HAVE INCREASED THE WESTERN SENSE OF ALIENATION FROM OTTAWA. EAST OF QUEBEC, POSSIBLE OIL SHORTAGES COULD HURT THE LIBERALS. EVEN IN QUEBEC WHERE TRUDEAU AND THE QUEBEC LIBERALS HAVE BEEN SUCCESSFUL IN CONTAINING SEPARATIST SENTIMENT, THE CONSERVATIVE OPPOSITION MAY BE MAKING HEADWAY AFTER BEING NEARLY WIPED OUT IN THAT PROVINCE IN THE 1972 ELECTION. THE PRESENT SITUATION MAKES EXPEDITIOUS GOVERNMENT ACTION DIFFICULT AND ELECTIONS APPEAR LIKELY IN 1974. THEIR OUTCOME IS HIGHLY UNCERTAIN, WITH SOME PUNDITS PROPHESYING ANOTHER MINORITY GOVERNMENT FACING SIMILAR PARLIAMENTARY INSTABILITY.

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4. ENERGY. THE ENERGY "CRISIS" DOMINATES THE ECONOMIC SCENE IN CANADA, THOUGH CANADA IS LIKELY TO SUFFER ONLY marginally FROM THE CUTBACKS AND DISLOCATIONS RESULTING FROM THE MIDDLE EAST SITUATION. THE CRISIS CUTS IN SEVERAL DIRECTIONS. IT HAS STIMULATED BOTH PRESSURES FOR NATIONALISTIC MEASURES AND RECOGNITION THAT CANADA CANNOT AND SHOULD NOT INSULATE ITSELF FROM THE REST OF THE WORLD, PARTICULARLY THE US. IT HAS BROUGHT HOME TO CANADIANS THE STRENGTH OF THEIR POSITION AS A RESOURCE-RICH

COUNTRY, YET IT HAS MADE THEM SHARPLY AWARE OF HOW DEPENDENT THEY ARE ON A HEALTHY US ECONOMY AND ON US FRIENDSHIP AND COOPERATION. IT HAS ENCOURAGED THE TREND TOWARD A MORE ACTIVE GOVERNMENT ROLE IN THE ECONOMY. IT HAS RESULTED IN CANADA DECIDING TO MAKE ITSELF SELF-SUFFICIENT IN ENERGY BY 1980 (THEREBY THREATENING THE REDUCTION OF ENERGY AVAILABLE FOR EXPORT TO THE US). IT HAS CREATED SERIOUS TENSIONS BETWEEN THE FEDERAL AND PROVINCIAL GOVERNMENTS. AND WHILE ECOLOGISTS CONTINUE TO PROTEST, IT HAS DEFUSED SOME ENVIRONMENTAL ISSUES, PARTICULARLY THE USE OF JUAN DE FUCA STRAIT BY US TANKERS FROM ALASKA TO THE CHERRY POINT REFINERIES. THE STRAIT IS NOW BEING TRAVERSED BY TANKERS CARRYING CANADIAN CRUDE OIL TO THE EASTERN PROVINCES.

5. ENERGY POLICIES. THE GOVERNMENT HAS MADE CLEAR THAT IN THE AREA OF ENERGY SUPPLY ITS PRIMARY OBJECTIVE IS TO ENSURE THAT CANADIAN REQUIREMENTS ARE MET AT PRICES AS REASONABLE AS POSSIBLE. TO THIS END IT IS CONTROLLING DOMESTIC PRICES OF PETROLEUM PRODUCTS, LIMITING EXPORTS TO AMOUNTS IN EXCESS OF DOMESTIC NEEDS, TAXING THESE EXPORTS--ALMOST ALL OF WHICH GO THE US--AT A RATE ROUGHLY EQUIVALENT TO THE DIFFERENCE BETWEEN CANADIAN AND WORLD PRICES, AND PLANNING EXTRAORDINARY EFFORTS TO MOVE OIL FROM THE PRODUCING PROVINCES IN WESTERN CANADA TO THE EASTERN PROVINCES WHICH HAVE TRADITIONALLY BEEN DEPENDENT ON IMPORTED OIL. EXTERNAL AFFAIRS MINISTER SHARP CHARACTERIZED THE SECRETARY'S ENERGY PROPOSAL AS MOST CONSTRUCTIVE AND STATED THAT CANADA IS PREPARED TO NOMINATE A REPRESENTATIVE TO THE ENERGY ACTION GROUP. AT THE SAME TIME, CANADA WILL BE CAUTIOUS ABOUT ANY SHARING OF THE EXPLOITATION AND MANAGEMENT OF ITS ENERGY RESOURCES.

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PA-04 PRS-01 USIA-15 IO-14 NEA-10 DRC-01 /216 W

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R 221714Z DEC 73
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6. US NEEDS. DESPITE THE BASICALLY "CANADA FIRST" THRUST OF THIS POLICY, US NEEDS HAVE BEEN TAKEN INTO ACCOUNT. FOLLOWING SOME ILL-ADVISED REMARKS AT FIRST BY ENERGY MINISTER MACDONALD WHICH SUGGESTED THAT CANADA MIGHT CUT OFF SUPPLIES TO THE US IF NECESSARY TO KEEP ARAB OIL FLOWING TO CANADA AND AFTER EXPRESSIONS OF US UNHAPPINESS OVER MEASURES SUCH AS THE EXPORT TAX, THE GOVERNMENT HAS EMPHASIZED BOTH PRIVATELY AT THE HIGHEST LEVEL AND PUBLICLY THAT ITS FRIENDSHIP WITH THE US WAS "NOT FOR RANSOM" AND THAT IT WOULD CONTINUE TO EXPORT OIL TO THE US ABOVE CANADA'S DOMESTIC REQUIREMENTS.

7. ECONOMY. IN OVERALL TERMS, THE DAMPENING EFFECT OF ENERGY SHORTAGES ON PRODUCTION AND ECONOMIC GROWTH IN OTHER COUNTRIES, ESPECIALLY THE US, WHICH TAKES ABOUT 70 PERCENT OF CANADIAN EXPORTS EQUIVALENT TO ABOUT 15 PERCENT OF CANADIAN GNP, MAY WELL PREVENT THE CANADIAN ECONOMY FROM GROWING IN 1974 AT THE RATE OF 5 1/4 TO 5 1/2 PERCENT IN REAL TERMS THAT IS NECESSARY TO PERMIT THE RAPIDLY GROWING LABOR FORCE TO BE ABSORBED. SOME OBSERVERS ARE ALREADY PREPARED TO SCRAP PREVIOUS FORECASTS OF A GROWTH RATE OF 5 1/4 - 5 1/2 PERCENT AND START REWRITING THE BOOK ON THE BASIS OF ENERGY SUPPLY CUTBACKS AND POSSIBLE INDUSTRIAL AND LABOR LAY-OFFS. ANY SERIOUS REDUCTION IN GROWTH RATE CAUSING
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MORE THAN SPOT UNEMPLOYMENT COULD CREAT REAL TROUBLES FOR THE GOVERNMENT. IN MORE SPECIFIC TERMS THE INTERRELATIONSHIPS BETWEEN THE US AND CANADA HAVE BEEN BROUGHT HOME BY CONCERN ABOUT, FOR EXAMPLE, INDUSTRIES IN US BORDER AREAS EMPLOYING CANADIAN WORKERS AND MATERIALS AND DEPENDENT ON CANADIAN OIL SUPPLIES, THE AVAILABILITY OF GASOLINE FOR CROSS-BORDER TOURIST TRAVEL, AND FUEL SUPPLIES FOR CANADIAN SHIPS AND AIRCRAFT. THERE APPEARS TO BE SOLID RECOGNITION OF THE FACT THAT ANYTHING CANADA CAN DO TO MINIMIZE THE US'S PROBLEMS WILL BE IN ITS OWN INTEREST. THIS DOES NOT IMPLY, HOWEVER, THAT THE FUTURE IS UNCLOUDED. THE NEED TO RECONCILE DOMESTIC IMPERATIVES AND US NEEDS WILL UNDOUBTEDLY REQUIRE A SERIES OF DIFFICULT DECISIONS BY CANADIAN AUTHORITIES.

8. FOREIGN OWNERSHIP. ENERGY PROBLEMS HAVE UNDERScoreD TO CANADIANS THE VALUE OF THEIR RESOURCE BASE, BUT ALSO THE FACT THAT A SIGNIFICANT PROPORTION OF IT IS OWNED OR CONTROLLED FROM OUTSIDE CANADA. YIELDING TO PRESSURE FROM "LIBERAL" FACTIONS WITHIN THE LIBERAL PARTY AS WELL AS FROM THE NDP, THE GOVERNMENT HAS PROPOSED THE ESTABLISHMENT OF A NATIONAL PETROLEUM CORPORATION

WHICH COULD EVENTUALLY ENTER ALL PHASES OF DEVELOPMENT, PRODUCTION, AND DISTRIBUTION. LIKE THE NEW FOREIGN INVESTMENT REVIEW AGENCY, ESTABLISHED UNDER RECENT LEGISLATION, THE SHORT-RUN EFFECT OF THE PETROLEUM CORPORATION WILL NOT BE GREAT. THERE ARE REGIONAL AND POLITICAL DIFFERENCES AS TO HOW SUCH LEGISLATION SHOULD BE USED. IN BOTH CASES, HOWEVER, MACHINERY WILL BE IN PLACE WHICH COULD EVENTUALLY CREATE SERIOUS PROBLEMS FOR THE PRIVATE SECTOR, INCLUDING US-OWNED INDUSTRIES, AND ITS VERY EXISTENCE MAY INHIBIT FUTURE FOREIGN INVESTMENT IN CANADA.

9. FOREIGN POLICY. AS THE YEAR ENDS, THE EARLIER DECISION TO "REDUCE CANADIAN VULNERABILITY" BY DIVERSIFYING TRADE AND OTHER CANADIAN INTERESTS ON A GLOBAL BASIS REMAINS AN ELUSIVE FOREIGN POLICY OPTION. AFTER HALVING ITS EUROPEAN NATO FORCES IN 1969, CANADA NOW IS CONCERNED THAT PERHAPS ITS VOICE IN EUROPEAN DEFENSE COUNCILS HAS DIMINISHED. CANADA WAS TAKEN RATHER ABACK AT THE EC PROPOSAL FOR A JOINT EC-US DECLARATION WITH ITS IMPLICIT EXCLUSION OF CANADA. CANADIAN BILATERAL LOBBYING WITH EC MEMBER STATES RESULTED IN AN EC INVITATION THAT CANADA PREPARE A DRAFT OF A POSSIBLE JOINT EC-CANADA DECLARATION. THE GOVERNMENT IS NOW WORKING TOWARD SUCH A PAPER, BUT IT RISKS BEING A FACE-SAVING CONFIDENTIAL

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DEVICE RATHER THAN MARKING THE BEGINNING OF A NEW INSTITUTIONALIZED RELATIONSHIP. TRUDEAU'S EARLY OVERTURES AND VISITS TO CHINA AND THE SOVIET UNION, EXCITING AT THE TIME, HAVE BEEN SOMEWHAT OVERTAKEN BY EVENTS, IN PARTICULAR THE NEW US RELATIONSHIPS WITH BOTH. THEY HAVE NOT AS YET BROUGHT ABOUT SIGNIFICANT NEW TRADING PATTERNS FOR CANADA. CONSEQUENTLY, THERE PROBABLY WILL BE INCREASED EMPHASIS BY CANADA ON ITS RELATIONS WITH ITS WESTERN EUROPEAN ALLIES. THE ENERGY CRISIS HAS BROUGHT THE INTERDEPENDENCE OF THE US AND CANADIAN ECONOMIES INTO SHARP FOCUS. WHILE STILL SEEKING DIVERSIFICATION, THE GOVERNMENT APPARENTLY RECOGNIZES THAT, FOR NOW AT LEAST, IT MIGHT BE BETTER FOR CANADA ITSELF TO AVOID DOING DAMAGE TO USINTERESTS.

10. CONCLUSION. TAKEN SINGLY, NONE OF THESE PROBLEMS APPEARS OVERWHELMING OR UNMANAGEABLE. AS THESE FACTORS INTERACT, HOWEVER, THEY CREATE A POLITICAL ATMOSPHERE OF UNCERTAINTY AND APPREHENSION OVER WHAT LIES AHEAD IN 1974. ON THE ECONOMIC SIDE, THERE ARE LIKELY TO BE SPOT PROBLEMS RESULTING FROM REPERCUSSIONS OF THE ENERGY CRISIS BUT, BARRING A MARKED DETERIORATION OF THE MIDDLE EAST SITUATION OR FAILURE OF US POLICY TO PREVENT A SERIOUS ECONOMIC DOWNTURN, THE CANADIAN ECONOMY SHOULD SURVIVE THE WINTER IN REASONABLY HEALTHY SHAPE. IN THESE CIRCUMSTANCES THERE IS A GOOD PROSPECT THAT THE LIBERAL PARTY, IF IT IS NOT TURNED OUT OF OFFICE SOON, WILL ITSELF LOSE PATIENCE WITH GOVERNING AT THE WHIM OF THE NDP AND SEEK A NEW ELECTORAL MANDATE WHEN THE SNOW MELTS.

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Message Attributes

Automatic Decaptioning: X
Capture Date: 01 JAN 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: n/a
Control Number: n/a
Copy: SINGLE
Draft Date: 22 DEC 1973
Decaption Date: 01 JAN 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Authority: garlanwa
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 28 MAY 2004
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1973OTTAWA03097
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: GS
Errors: N/A
Film Number: n/a
From: OTTAWA
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1973/newtext/t1973128/aaaaafxh.tel
Line Count: 277
Locator: TEXT ON-LINE
Office: ACTION EUR
Original Classification: CONFIDENTIAL
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 6
Previous Channel Indicators:
Previous Classification: CONFIDENTIAL
Previous Handling Restrictions: n/a
Reference: n/a
Review Action: RELEASED, APPROVED
Review Authority: garlanwa
Review Comment: n/a
Review Content Flags:
Review Date: 12 SEP 2001
Review Event:
Review Exemptions: n/a
Review History: RELEASED <12-Sep-2001 by smithrj>; APPROVED <15-Nov-2001 by garlanwa>
Review Markings:

Declassified/Released
US Department of State
EO Systematic Review
30 JUN 2005

Review Media Identifier:
Review Referrals: n/a
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
Secure: OPEN
Status: NATIVE
Subject: FOURTH QUARTER REPORT: CANADA
TAGS: PFOR, CA
To: STATE
Type: TE
Markings: Declassified/Released US Department of State EO Systematic Review 30 JUN 2005